

JOHN M. KNOX & ASSOCIATES, INC.

April 9, 2005

TO: Councilmember Joann Yukimura
CC: Scott Ezer, Helber Hastert Fee
FM: John Knox
RE: **"Kibitzing" on Kaua'i Vacation Rental Issues**

Aloha Councilmember Yukimura –

Thank you again for inviting me to participate in your initial forum on vacation rental issues, and congratulations on your excellent and productive discussion!

As we discussed briefly, I would like to offer you my own thoughts – for whatever they may be worth – on possible fruitful or unfruitful directions for your process. This was inspired by your panel's closing discussion on "most important issues."

(1) Enforcement Mechanisms: I agree with those among your panel who felt this is a critical concern. Most Hawai'i counties face problems today not because of a lack of laws and regulation, but because lack of enforcement resulted in a situation where nobody felt the rules were particularly important. More specifically –

- The financing of enforcement mechanisms is an especially important aspect. You may want to contact O'ahu Councilman Barbara Marshall's office to see why they believe they need special State authority to put vacation rental licensing fees into a dedicated fund for enforcement purposes.
- It might be useful for the panel to review Helber Hastert's findings about what other communities have done on funding and implementing "enforcement mechanisms" as soon as possible. If you find that experience shows certain enforcement approaches just haven't worked (or have had big unforeseen consequences), you'll have a better idea of what your true set of choices are.

(2) Mechanisms for Achieving "Balance" in Residential Areas: Similarly, knowing as soon as possible how other communities have tried to address this question – and with what success – can help the group focus on what it thinks are really feasible options.

Former Honolulu Planning Director Eric Crispin threw out an interesting idea in a bull session we had on this topic: "Maybe you could come up with rules about limiting the number of other TVRs within an X-foot radius of existing operations." I'm sure there are ramifications to this approach, but it would avoid or mitigate what I see as big difficulties in trying to set *percentage* caps – i.e., do you base percentages on vacation rental beds, rooms, structures, or total properties? how

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do you define the affected area, and do things like multiple homes and vacant lots affect calculation of percentages?

- (3) **Different Ways to Define "Balance" for Different Neighborhoods:** Even though you may not always want to write percentages into your final guidelines, they're probably the best interim way to have a discussion about the fact that "balance" may appropriately differ by community. There may be places where everybody feels the effective cap should be just something like 5% - 10%; other places, 20% or more. Or maybe even – actual beachfront, OK, up to 33%. (If you went the radius approach, that could translate into a smaller or larger radius.)

I think it would be draconian, but maybe there are places you want to designate as 0% TVR. On the other hand, you may also have to bite the bullet and say there are some places where vacation rentals (or vacation homes *cum* vacation rentals) are so plentiful that it's become impractical to set any limit whatsoever – they should be accepted as a new type of low-density, multi-owner resort area that is a permissible "mixed use," co-existing with some level of full-time residential activity.

After all, even the "master-planned resorts" are now focused pretty much on upscale vacation homes and timeshare projects, not hotels. And – shy of war, plague, or another Great Depression – can we really foresee a future scenario whereby the Ha'ena beach area returns to primarily full-time residential use? Perhaps we can realistically expect gradual attrition of non-residential uses in some places under a new regulatory regime, but not necessarily everywhere. And the political paralysis that has prevented action in other counties might be avoided if key existing concentrations of TVRs are legitimated, with enforcement focused mostly on still-residential areas that feel threatened by future conversion to TVRs.

- (4) **Think in Terms of Visitor Demand & Supply Factors:** "Balance" is also a matter of realistically weighing supply issues (preservation of neighborhood character) against *visitor* (not just real estate investor) demand. Market demand is sort of like flood water – you might spend a whole bunch of money to dike off one area, but then it just tends to flow somewhere else nearby. So looking for new ways or places to increase supply (to channel the "flood water") may have to be considered.

This gets back to my point about better understanding actual visitor demand for different Kaua'i accommodations.

- Are people staying in non-hotel units on Kaua'i much more than other islands simply because Iniki wiped out hotels there during a period when hotel economics are discouraging new hotel products – i.e., if you *could* build more hotels (as Chief Economist Pearl Iboshi thinks), would that really reduce demand for lodging in, and pressure on, residential neighborhoods?
- To what extent is there really specific demand for a "personal" experience in an area with bona fide residents next door, vs. a more general demand for a nice home in a nice location at a nice price (whoever's staying next door)? If

it's mostly the former, then the industry isn't sustainable past a certain point – existing operators themselves have a stake in capping new supply! But if it's mostly the latter, then residential areas are being affected as a byproduct of a more general demand, not because they're the actual focus of a specific demand for a personalized residential experience. In which case, where or how else could Kaua'i meet that more general demand? Would/should those ways still permit local small-business folks to get a big slice of the TVR pie?

(By the way, I think it's one thing to ask if you want to keep encouraging new demand through marketing, but it's another to ignore or deny existing demand. If you choose to say, "We as a society refuse to meet market demand," then you have to be prepared to spend a lot of money on policing the black market entrepreneurs who inevitably will try to meet it – remember Prohibition!)

- (5) **"Affordable Housing" Vs. "Property Tax" Focus:** In principle, I agree with those who said that affordable housing is a critical issue for this discussion. But in practice, I think it will prove quicksand in which the group can drown before it ever reaches consensus. There are just too many questions about cause and effect, too many larger issues. It's a great subject to argue about over a beer, but it will sure be hard to come up with agreement on action steps to limit vacation rentals on the understanding that the intended outcome is more affordable housing. (Anyway, I'd guess that some residential-area vacation rentals, like Princeville condos, will turn into relatively "affordable residential rentals" either when the visitor economy goes into slumps or else when the economy gets so heated that pent-up resident housing demand finally surpasses visitor demand!)

However, there's a narrower aspect of housing economics that may be more actionable if Kaua'i does a better job of licensing and tracking TVRs – and that is the property tax issue. At least in my own neighborhood, people are worried about that alleged chain of investors¹ paying (what people suspect are) even higher than normal prices for modest homes. The belief is that buyers are paying more based on the expectation of higher income potential from short-term vacation rentals, vs. "just" the extra income that some people get from long-term rentals of that converted (equally illegal) unit over the garage. We worry our own property taxes will go up, based on how their expected non-residential income affects sales prices.

If we were able to track sales values of residential properties that were already operating as B&Bs or vacation rentals – or that applied for a license within, say, a year after purchase – we could see if there truly is much of a difference. And, if so, we could then choose to base property taxes on actual non-residential uses, not

¹ Louie Abrams' presentation has made me wonder if this investor group supposedly operating 13 vacation rentals in my small neighborhood consists of really bad business people ... or if they are really *good* business people who will be the survivors and leaders of a more commercialized/professionalized vacation rental industry after the part-time vacation home folks get discouraged and drop out!

just residential *zoning*. Over time, this might even encourage voluntary attrition of TVR use in some residential areas where it is now regarded as problematic.

As with my slide presentation, I've gone on longer than I planned. Thanks for your consideration of this kibitzing!